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January 16, 2007

By Hand Delivery

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Subject: Application of the Countervailing Duty Law to Imports from the People's Republic of China: Request for Comment

Dear Ms. Kuhbach:

In response to the December 15, 2006, *Federal Register* notice (71 FR 75507) from the U.S. Department of Commerce (Commerce) seeking comment on the application of the countervailing duty law to imports from the People's Republic of China, the following comments are submitted on behalf of the members of the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union, AFL-CIO-CLC ("USW").

The USW is supporting Commerce's current countervailing duty investigation on coated free sheet paper from the People's Republic of China as many of our members are employed by domestic producers of coated free sheet paper in the United States.¹ We have also been active in a large number of other trade remedy cases before Commerce for many decades. We have a deep interest in seeing U.S. trade remedy laws vigorously enforced. It is often our members who

¹ The USW's letter of support for the CVD Petition on coated free sheet paper from China is included as Exhibit I-2 to the antidumping and countervailing duty petitions filed on October 31, 2006 by New Page Corporation.

are the direct casualties of unfair trade practices by our trading partners, as our members lose jobs, suffer a diminution in compensation and benefits and see their employers less able to compete as unfairly traded imports reduce investments, research and development, training and other expenditures critical to maintaining a strong manufacturing base and the jobs that support that base.

SUMMARY

In 1984, Commerce made a policy decision that, as a matter of definition and because of the economic system that existed in non-market economy countries, U.S. countervailing duty (CVD) law does not apply to non-market economies. As Commerce's *Federal Register* notice states: "In 1986, the Court of Appeals for the Federal Circuit affirmed that the Department of Commerce (the Department) had the discretion not to apply the countervailing duty law to non-market economy (NME) countries in *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986) (*Georgetown Steel*).” See 71 FR 75507. Commerce has followed that approach in later cases, including *Chrome-Plated Lug Nuts and Wheel Locks from the People's Republic of China*, 57 FR 10459 (March 26, 1992), and *Oscillating and Ceiling Fans from the People's Republic of China*, 57 FR 24018 (March 26, 1992).

The legal and economic bases upon which Commerce made that policy decision in the 1980s have changed. The WTO Uruguay Round negotiation resulted in a new Agreement on Subsidies and Countervailing Measures (SCM Agreement) that included a new and more specific definition of subsidies. This SCM Agreement definition of subsidies was implemented into U.S. law in 1994, after the *Georgetown Steel* litigation and the subsequent cases on China in 1991-92. Moreover, as part of its accession to the WTO in 2001, China accepted that trading partners would be able to use special rules for valuing prices and costs in antidumping investigations and

accepted special rules for valuing subsidies. These subsidy valuation rights are not premised on any abandonment of special rules (*i.e.*, treatment of China as an NME). These rights were negotiated by the United States because of concerns about the nature of the Chinese economy. Indeed, trade-distorting subsidies from the Chinese government were one of the specific concerns of the United States in negotiating China's accession to the WTO.

In addition to these legal changes, there have been important economic changes since Commerce made its policy decision in 1984. The economic shifts are reflected in trade flows and adverse impacts on U.S. companies' revenues, profits and employment.

For these reasons, it is time that the full panoply of rights intended to ensure fair competition for U.S. businesses and provide remedies for companies, workers and communities injured by unfair trade be reflected in U.S. policy toward non-market economies like China.

In order to change its policy, Commerce need only provide a reasoned basis for a change in policy. An examination of relevant WTO documents and Commerce practice indicate there are no policy constraints which would make problematic the application of both the NME antidumping methodology and U.S. countervailing duty law to China.

Commerce can and should change its policy in the context of the ongoing investigation on coated free sheet paper from the PRC. A statutory change, while always possible, is not needed for Commerce to better meet the statutory purposes and intent of Congress in applying the U.S. countervailing duty law in conjunction with the U.S. NME antidumping methodology. In short, it is essential that U.S. companies and their workers have access to the full panoply of trade remedies to address distortions caused by the actions of the Chinese companies and their government at the central, provincial and local level.

I. BACKGROUND TO COMMERCE'S POLICY OF NOT APPLYING COUNTERVAILING DUTY LAW TO NON-MARKET ECONOMIES.

Since 1984, Commerce has considered that countervailing duty law cannot be applied to exports from a Non-Market Economy (NME) country because subsidization is a market economy phenomenon which cannot exist in an NME. Commerce first made this determination in 1984 in *Carbon Steel Wire Rod from Czechoslovakia*, 49 FR 19370 (May 7, 1984) (final negative CVD determination) and *Carbon Steel Wire Rod from Poland*, 49 FR 19374 (May 7, 1984) (final negative CVD determination). Following these decisions, Commerce rescinded initiations of CVD investigations on imports of potash from the Soviet Union and the German Democratic Republic. At that time, all four countries (Czechoslovakia, Poland, the Soviet Union, and the German Democratic Republic) were considered non-market economies because each was characterized by central government control of prices and allocation of resources.

Commerce's NME classification was founded on an economic analysis that concluded that, in countries that relied on the existence of central planning to allocate resources and prices, markets did not exist. Commerce said:

We believe a subsidy (or bounty or grant) is definitionally any action that distorts or subverts the market process and results in a misallocation of resources, encouraging inefficient production and lessening world wealth.

In NME's, resources are not allocated by a market. With varying degrees of control, allocation is achieved by central planning. Without a market, it is obviously meaningless to look for a misallocation of resources caused by subsidies. There is no market process to distort or subvert. Resources may appear to be misallocated in an NME when compared to the standard of a market economy, but the resource misallocation results from central planning, not subsidies.

It is this fundamental distinction -- that in an NME system the government does not interfere in the market process, but supplants it -- that has led us

to conclude that subsidies have no meaning outside the context of a market economy.²

Thus, Commerce believed that, without markets, there would be no way to quantify NME subsidies. Because of pervasive control of prices and resources, Commerce said it could not disaggregate government actions in such a way as to identify the exceptional action that is a subsidy.

Commerce's decision was contested and the U.S. Court of International Trade (CIT) reversed it.³ However, upon appeal to the U.S. Court of Appeals for the Federal Circuit (CAFC), the CIT's decision was reversed and Commerce's decision was affirmed.⁴ The CAFC accepted Commerce's reasoning because it could not say that Commerce's decision was "unreasonable, not in accordance with law, or an abuse of discretion" in view of the discretion accorded administrative agencies.⁵ The CAFC also agreed that subsidized unfair competition cannot exist in an NME. Quoting Commerce, the CAFC said:

[T]he nonmarket environment is riddled with distortions. Prices are set by central planners. "Losses" suffered by production and foreign trade enterprises are routinely covered by government transfers. Investment decisions are controlled by the state. Money and credit are allocated by the central planners. The wage bill is set by the Government. Access to foreign currency is restricted. Private ownership is limited to consumer goods.⁶

Based on this understanding of the way NMEs worked at that time, and specifically with reference to "export incentives," the CAFC opined that "even if one were to label these

² *Carbon Steel Wire Rod from Czechoslovakia*, 49 FR 19370, 19371 (May 7, 1984) (final negative CVD determination) (emphasis added); *Carbon Steel Wire Rod from Poland*, 49 FR 19374, 19375 (May 7, 1984) (final negative CVD determination) (emphasis added).

³ *Continental Steel Corp. v. United States*, 614 F. Supp. 548 (CIT 1985).

⁴ *Georgetown Steel Corp. v. United States*, 801 F.2d 1308 (Fed. Cir. 1986).

⁵ *Georgetown Steel Corp.*, 801 F.2d at 1318, citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

incentives as a 'subsidy,' in the loosest sense of the term, the governments of those nonmarket economies would in effect be subsidizing themselves.”⁷

Thus, the bases for Commerce's policy of not applying U.S. CVD law to NMEs may be summarized as follows:

- (1) Definitional: a subsidy is any government action that distorts markets;
- (2) Economic/Factual: production and investment and prices are all controlled by central planning which results in a market that is not rational, leaving prices and costs meaningless, and subsidies impossible, as subsidies are only meaningful in market economies; and
- (3) Practical: there are no benchmarks in an NME with which to quantify any subsidies.

II. COMMERCE'S AND THE CAFC'S ANALYSES HAVE BEEN OVERTAKEN BY SUBSEQUENT DEVELOPMENTS.

It has been more than 22 years since the original Commerce decisions and twenty years since the CAFC's affirmance of Commerce's policy. In that time, there have been many developments relevant to the rationales relied upon by Commerce and the CAFC. In fact, based on an analysis of current factors, Commerce has changed the status of the Czech Republic and Slovakia (successor states to Czechoslovakia), Poland, and Russia from "non-market" to "market" economies. While China remains a non-market economy for antidumping purposes, as reconfirmed in the lined paper case last year, there still have been significant changes in the Chinese economy and the nature of the manufacturing sector.

⁶ *Georgetown Steel Corp.*, 801 F.2d at 1315.

⁷ *Georgetown Steel Corp.*, 801 F.2d at 1316.

A. Definition of a Subsidy

In 1994, the United States enacted the Uruguay Round Agreements Act, implementing the results of the Uruguay Round negotiations establishing the World Trade Organization. Revised agreements, including the Agreement on Subsidies and Countervailing Measures (ASCM) were also adopted. The original GATT Articles (including VI, XVI, and XXIII) were not amended.

One of the notable features of the new SCM Agreement was that, for the first time, an explicit and expansive definition of subsidies was agreed upon. Although the prior 1979 Subsidies Code, and GATT Articles VI (Antidumping and Countervailing Duties), XVI (Subsidies) and XXIII (Nullification or Impairment of Benefits Through Government Action) provided rules for subsidies discipline and application of countervailing duties, they did not provide a definition of a subsidy. The 1979 Subsidy Code used the terms “subsidy” and “subsidize” without elaboration. GATT Article XVI, paragraph 1, referred to “any subsidy” as including “any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into” a country. The definitional gap was filled by Article 1 of the WTO SCM Agreement, which states that a subsidy shall be deemed to exist if:

- (a)(1) there is a financial contribution by a government or public body,⁸
or
- (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;
and
- (b) a benefit is thereby conferred.⁹

⁸ A “financial contribution” includes any direct or potential direct transfer of funds (*e.g.*, grants, loans, equity infusions, or loan guarantees); forgone revenue (*e.g.*, fiscal incentives such as tax credits); provision of goods (other than general infrastructure) or purchase of goods; and payments to a funding mechanism or direction of a private body to carry out what would normally be government functions. *ASCM*, art. 1.1(a)(1)(i)-(iv).

Article 2 of the SCM Agreement requires that, to be actionable, a subsidy must be given to a specific enterprise or industry or group of enterprises or industries.¹⁰

Significantly, the SCM Agreement, unlike Commerce's 1984 working definition and GATT Article XVI, defines a subsidy based on what it is, instead of what it does. This approach is much more practical because a subsidy can be identified by its characteristics, and it is not necessary to examine the effects of a subsidy in order to determine whether it is, in fact, a subsidy.

In view of the current WTO and U.S. statutory definition of a subsidy, Commerce's 1984 definition of a subsidy as being any action that distorts markets should be found to be no longer relevant or controlling. Absent the "economic effects" approach used by Commerce in 1984, there is no basis not to apply CVD law to NMEs. Notwithstanding that the result of a subsidy may be market distortion, that effect is not the standard by which to judge whether an action is a subsidy.

Neither the WTO SCM Agreement nor U.S. law on its face provides for an NME exception from the application of CVD law or WTO disciplines. Interestingly, the CIT's decision in *Continental Steel* noted that the CVD law specifically applies to "any country."¹¹ Although Commerce recognized this, it considered that the nature of NMEs required an additional jurisdictional test to determine if NMEs could subsidize. However, the CIT said that a failure to meet this jurisdictional criteria would amount to a *per se* exemption and be in conflict

⁹ ASCM, art. 1.1. This provision is implemented in U.S. law by Section 771(5)(B) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(5)(B).

¹⁰ ASCM, art. 2. This provision is implemented in U.S. law by Section 771(5A) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(5A).

¹¹ *Continental Steel Corp. v. United States*, 614 F. Supp. 548, 550 (CIT 1985).

with the plain statement that the law covers *any* country.¹² The CAFC's decision did not comment on the CIT's determination that CVD law applies to subsidies in *any* country. The CAFC reversed the CIT because it determined that Commerce's conclusion that NMEs could not confer a subsidy was not unreasonable, accepting Commerce's definition of a subsidy and its characterization of non-market economies.¹³

Although the SCM Agreement's change of subsidy definition alone would be a basis for Commerce to change its policy, an examination of the evolution of economic and factual conditions is needed to determine if, in fact, subsidies exist in China and are measurable.

B. *Economic Rationale: Production, Investment, and Prices Are All Controlled by Central Planning Which Results in a Market That is Not Rational*

Since there is now a definition of a subsidy, the current economic circumstances in China need to be examined in relation to Commerce's 1984 decisions to see whether subsidies can and, in fact, do exist in China. The economic situation in China today is far different than the economic situation that existed in the four NMEs that Commerce described in 1984. China is in the process of a gradual liberalization of its markets, which was acknowledged in the Agreement on Market Access between China and the United States of November 15, 1999 (at p. 4). Now, it is not accurate to characterize China as having an economy totally directed by the State and one in which the State owns or controls all means of production. Currently, much of China's GNP is produced by private enterprises with a declining share produced by State-controlled enterprises. In China today, there is joint venture production by foreign firms and increasing amounts of foreign direct investment.

¹² *Continental Steel Corp*, 614 F. Supp. at 550 (emphasis in original).

1. Independent studies of the Chinese Economic System

The transition of China from a state-directed economy was reviewed in a 1993 study published by the International Monetary Fund.¹⁴ This study identified four phases of reform:

1. 1978-1984: Government policies placed greater emphasis on material incentives and allowed a larger role for the market. Farming was decentralized from the cooperative to the household level. China began to experiment with allowing State-owned enterprises to retain profits. Preferential policies were conferred on special economic zones to attract foreign investment, and act as laboratories for bolder market-oriented reforms.
2. 1984-1988: Reform in the urban industrial centers, following the success of decentralization of farming. This included the introduction of taxation of enterprises, reform of the wage system to establish a link between productivity and pay, opening of 14 major cities to foreign investment, and other market oriented reforms.
3. 1988-1991: Retrenchment. The prior reforms spurred demand and production, leading to double-digit inflation. Some earlier reforms were reversed under a “Rectification” program which stabilized prices but caused a sharp slowdown in the economy.
4. 1992-1993: (up to the date of the IMF report) An end to the “rectification” program and a decision to accelerate the process of reform and opening up, establishing the goal of creating a “socialist market economy system.” The Chinese constitution was amended in 1992 to delete references to a planned economy and establish the new goal of creating a market system.

The economic structure of China continued to change after 1993. A study by PriceWaterhouseCoopers estimated that two-thirds of China’s GDP is generated by the non-state sector, and around half contributed by domestic private enterprises.¹⁵ This study further noted that registered private businesses rose from 90,000 in 1998 to over two million in 2001. Another study by the OECD found that, from 1991 to 2003, the share (by volume) of transactions

¹³ *Georgetown Steel Corp.*, 801 F.2d at 1318.

¹⁴ Michael W. Bell, Hoe Ed Khor, and Kalpana Kochar, *China at the Threshold of a Market Economy* (IMF, 1993).

¹⁵ Allan Zhang, *Hidden Dragon: Unleashing China's Private Sector* (PriceWaterhouseCoopers, 2003); available at <http://www.pwcglobal.com/extweb/newcolth.nsf/docid/3D15C57A6D220BB985256CF6007B9607>.

occurring at market prices in China rose from 46 percent to 87 percent for producer goods, from 69 percent to 96 percent for retail sales, and from 58 percent to 97 percent for farm commodities.¹⁶ The study also found that the private sector's share of industrial value added rose from 27.9 percent in 1998 to 52.3 percent in 2003. While, as Commerce's review of whether China should continue to be treated as a non-market economy in 2006 demonstrated, China remains involved in many ways in the Chinese economy making continued treatment as an NME warranted, it is nonetheless the case that the economic changes in China create more market aspects than was true in the early 1980s.

2. Commerce's calculation of individual dumping margins for Chinese exporters

Commerce itself has recognized the Chinese market reforms in its antidumping investigations of Chinese products. While still considering China to be a non-market economy, Commerce has recognized in practice that state control is not all-pervasive. Since 1991, Commerce has allowed Chinese exporters to receive an "individual" rate of dumping duty if the exporter can demonstrate in law and in fact that no level of government controls its export activities.¹⁷ Since 1991, virtually all Chinese exporters have received individual rates, with the exception of companies who failed to provide accurate and verifiable responses to Commerce questionnaires or submitted deficient separate rate applications.¹⁸ These companies are given the

¹⁶ Sean Dougherty and Richard Herd, *Fast-Falling Barriers and Growing Concentration: the Emergence of a Private Economy in China*, OECD Economics Department Working Papers No. 471, ECO/WKP(2005)8 (Dec. 16, 2005).

¹⁷ *See Sparklers from the PRC*, 56 FR 20588 (May 6, 1991) (final LTFV determination).

¹⁸ In 2005, Commerce changed the process for granting Chinese companies individual margins because so many firms had begun to apply for them, imposing an administrative burden on the agency. Commerce developed an application form for exporters seeking separate rates in order to provide more explicit instructions to exporters and provide notice of the specific documentation required. The eligibility factors considered in making the separate rates determination did not change. *See Separate Rates and Combination Rates in Antidumping*

China-wide rate. The practice of calculating individual rates has become routine in Commerce's preliminary determinations of sales at less than fair value in cases concerning Chinese imports. When the granting of separate rates has been contested in final determinations, as long as the company has provided accurate responses to the Department, Commerce almost invariably concludes the subject Chinese company is free of government control of its export activities and deserves an individual rate based on its own factors of production.

In making its decision as to whether individual companies are free of government direction and control, Commerce examines two sets of factors, neither of which existed in the NMEs described by Commerce in 1984. The first step is to examine three *de jure* factors:

1. Whether there are restrictive stipulations associated with the exporter's business and export licenses;
2. Legislative enactments decentralizing control of companies; and
3. Other formal measures by the Government decentralizing control of companies.

The second step is that, in addition to the legal status of an exporter, Commerce examines four *de facto* items:

1. Whether the export prices are set by, or subject to the approval of, a governmental agency;
2. Whether the respondent has the authority to negotiate and sign contracts and other agreements;
3. Whether the respondent can retain the proceeds from its export sales and make independent decisions regarding the disposition of profits or financing of losses; and
4. Whether the respondent has autonomy from the government regarding the selection of management.

This set of criteria has been routinely applied by Commerce in NME cases for many years.¹⁹ Yet none of the *de jure* and *de facto* factors Commerce now routinely examines were foreseen in 1984.

The practice of granting individual rates to individual Chinese exporters has become normal; almost all respondents who ask for individual rates and provide the required information to Commerce receive separate rates. The very frequency of Commerce determinations in which separate rates are appropriate indicates how much China differs from the typical NME conditions that Commerce examined in 1984.

3. Legal changes in China

On December 22, 2003, the Communist Party formally tabled an amendment to the Chinese Constitution to provide that "private property obtained legally shall not be violated."²⁰ The members of the Standing Committee of the National People's Congress (NPC) passed the draft amendments to the Constitution in Beijing on December 27, indicating that formal adoption

¹⁹ A typical example would be the 2003 decision on Malleable Cast Iron Pipe Fittings from the PRC. In that case, of the four respondents receiving individual rates, U.S. firms wholly or partially owned three of the respondents. The fourth was an employee-owned enterprise. See *Preliminary Determination of Sales at Less than Fair Value, Certain Malleable Iron Pipe Fittings from the PRC*, 68 FR 33911, 33913-33915 (June 6, 2003). The preliminary determination of separate rates was unchallenged and unchanged in the Final Determination, 68 FR 61395 (October 28, 2003).

would be in March 2004.²¹ The amendment was submitted to the national legislature on March 8, 2004 and was adopted on March 14, 2004.²²

4. Notwithstanding substantial progress by China in liberalizing its market, Commerce still considers China to be a non-market economy country.

As reviewed above, China has made significant progress in opening up its economic system, instituting legal reforms, and lessening government control of the market, and Commerce has acknowledged this progress by allowing NME exporters to request individual dumping rates where they can show absence of government control. Yet, notwithstanding this progress, China has not yet achieved the status of a "market" economy. Indeed, state-owned enterprises continue to account for a significant proportion of the Chinese economy. For example, in a survey of the Chinese economy, The Economist noted:

The contrast between old and new in the state sector is at its starkest in China's north-eastern "rustbelt", where state-owned enterprises (SOEs) generate 70% of GDP. But it exists throughout the country, and shows how much further SOE reform has to go.

It is no exaggeration to say that China's economic future depends on such reform. In 2002, the state controlled half of industrial output, and SOEs still account for 35% of urban employment, despite having halved their workforce in the past 12 years. Virtually all of China's heavy industry and much of its technology is in state hands. Half of all bank loans go to SOEs. This crowds out the private sector, China's growth engine, and threatens the entire financial system, because most of those loans will never be repaid.²³

²⁰ See Richard Spencer, *China amends constitution to protect private property*, The Age, Dec. 24, 2003; available at <http://www.theage.com.au/articles/2003/12/23/1071941725876.html>.

²¹ See Website of the Embassy of the People's Republic of China in the United States of America, <http://www.china-embassy.org/eng/gyzg/t57116.htm>.

²² See *Draft amendment to constitution submitted to NPC session*, People's Daily, March 8, 2004; available at http://english.peopledaily.com.cn/200403/08/eng20040308_136881.shtml; *Top Legislature Closes Session, Adopts Amendment to Constitution*, Xinhua News (March 14, 2004); available at http://news.xinhuanet.com/english/2004-03/14/content_1365556.htm.

²³ *We are the champions*, THE ECONOMIST, March 20, 2004.

As such, even though China is engaged in substantial economic reforms, the United States correctly continues to treat China as an NME under U.S. antidumping law.²⁴ Such a position is consistent with U.S. rights and obligations under the World Trade Organization, most particularly China's Protocol of Accession. Continued treatment of China as an NME for antidumping purposes should not, however, affect Commerce's willingness to pursue subsidies granted to Chinese producers under existing U.S. countervailing duty law.

C. China's Accession to the WTO

In the negotiations with China regarding accession to the WTO, the U.S. government negotiated strongly, and successfully, to impose disciplines on Chinese subsidies. These conditions for WTO membership became part of the Protocol of Accession for China. China agreed to eliminate all export subsidies.²⁵ China also agreed that WTO Member authorities could use non-Chinese benchmarks for subsidy quantification if Chinese benchmarks were not available or could not be adjusted.²⁶

Annex 5A to China's WTO Accession Protocol listed 24 domestic subsidy programs which China did not agree to terminate or phase out. However, some members of the Working Party on the Accession of China to the WTO considered the list incomplete.²⁷ In particular, they

²⁴ Commerce recently examined the NME status of China in the antidumping duty investigation of Certain Lined Paper Products from the People's Republic of China. Commerce concluded: "While China has enacted significant and sustained economic reforms, our conclusion ... is that market forces in China are not yet sufficiently developed to permit the use of prices and costs in that country for purposes of the Department's dumping analysis. The Department shall, therefore, continue to treat China as an NME for purposes of the U.S. antidumping law." *See* Antidumping Duty Investigation of Certain Lined Paper Products from the People's Republic of China (A-570-901): *Commerce Memorandum re China's Status as a Non-Market Economy*, August 30, 2006, at 82; available at <http://ia.ita.doc.gov/download/prc-lined-paper-memo-08302006.pdf>.

²⁵ Protocol of Accession of the Peoples Republic of China, WT/L/432 (23 November 2001) at Item 10.3.

²⁶ Protocol of Accession of the Peoples Republic of China, WT/L/432 (23 November 2001) at Item 15.

²⁷ Report of the Working Party on the Accession of China, WT/MIN(01)/3 (10 November 2001) at para. 173.

felt that some subsidies, such as “policy” loans by State-owned banks, forgiveness of debt, and the selective use of “below-market” interest rates should have been notified.²⁸ There was also reference to unnotified tax subsidies, and subsidies provided by sub-national governments. In Annex 5B to the Protocol, China listed three export subsidies to be phased out, but some members of the Working Party also considered this list incomplete.²⁹

It is notable, when reviewing the U.S.-China Accession Agreement and the WTO Accession Protocol and Report of the Working Party, that the Members of the WTO, including the United States, developed and approved accession documents that identified Chinese domestic and export subsidies and provided alternate methods of subsidy measurement. There is no indication that any of the Members involved in the accession process, including China itself, believed that subsidies do not, or could not, exist in the present Chinese economy. It would be strangely inconsistent for the United States to negotiate disciplines for Chinese subsidies while, at the same time, adhering to a policy that subsidies could not exist in China or that such subsidies were not distortive of international trade flows.

Notably, four years after its WTO accession, China submitted the first notification of its subsidies to the WTO in which China identified 78 subsidy programs.³⁰ Moreover, the notice of initiation to the Coated Free Sheet Paper CVD investigation identifies numerous Chinese programs that the petitioner alleges provide countervailable subsidies.³¹

²⁸ *Id.*

²⁹ *Id.* at para. 166.

³⁰ See Subsidies: New and Full Notification Pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement, G/SCM/N/123/CHN (13 April 2006).

³¹ See *Notice of Initiation of Countervailing Duty Investigations: Coated Free Sheet Paper from the People's Republic of China, Indonesia, and the Republic of Korea*, 71 FR 68546, 68548 (Dep't Comm. Nov. 27, 2006). The Chinese programs identified include grant programs, policy loans, preferential tax programs for encouraged industries including the paper industry, the “two free, three half” program, income tax exemptions program for

D. Practical Constraints: Lack of Benchmarks to Measure Subsidies

In 1984, Commerce believed that, due to the absence of markets, there could be no benchmarks in an NME with which to quantify any subsidies. Today, however, Commerce has moved far away from its 1984 views of non-market economies, as evidenced by its choice of factors to examine in determining whether individual Chinese firms are free of government direction and control in their export activities, and its decisions to grant separate rates.

Of course, there is still a need to quantify any subsidy in order to countervail it. A common benchmark in CVD investigations in measuring preferential loans or identifying the discount rate for grants is the market rate of interest. The International Monetary Fund publishes three interest rates for China in its *International Financial Statistics*: the Bank Rate, Deposit Rate, and Lending Rate.

It would not be unusual if practical difficulties arose in the course of investigating Chinese subsidies, but Commerce will not know if this is so unless, and until, it actually conducts CVD investigations of Chinese imports. One would not expect to find perfect markets in China, given that state control of a number of economic activities are still in place. However, Commerce has never said that the market must be perfect in order to determine subsidy benchmarks.³² In any event, the current economic structure in China bears no relation to the economic structure that existed in 1984. If, upon investigating a Chinese subsidy, Commerce encounters practical difficulties in finding a benchmark, the default conclusion surely should not

foreign investment enterprises (FIEs) located in certain geographic locations, local income tax exemption and reduction program for “productive” FIEs, income tax exemption program for export-oriented FIEs, corporate income tax refund program for reinvestment of FIE profits in export-oriented enterprises, debt-to-equity infusion for APP China; and subsidies to input suppliers. *See id.*

³² In the 1984 *Wire Rod* cases, Commerce said that few modern economies are purely market driven. *See Carbon Steel Wire Rod from Czechoslovakia*, 49 FR at 19371; *Carbon Steel Wire Rod from Poland*, 49 FR at 19375.

be that a subsidy does not exist. As noted above, in the WTO Protocol of Accession, China agreed that Members may use external benchmarks, even if only after consideration of internal benchmarks.

III. THERE ARE NO LONGER ANY VALID POLICY CONSTRAINTS TO APPLYING CVD LAW TO NMEs, SUCH AS CHINA

A. An "Effects" Test is Not Relevant to Whether CVD Law Should Apply to NMEs, Such as China

Some observers have suggested that a change in Commerce's current policy of not applying CVD law to NMEs would be pointless. They assert that, in order to be considered countervailable, a subsidy must cause the recipient to change its prices or production output because, if a recipient did not do so, the subsidy would have no impact on importing country industries. Yet, in NMEs, they argue, a subsidy does not cause the recipient to change its prices or production volume because decisions as to resource allocation, pricing, and production are determined by the national or local government that conferred the subsidy, not by the subsidy recipient. This is not a valid concern or basis for maintaining Commerce's current policy. Indeed, this view conflicts with the statute, regulations, and Commerce's policy -- each of which hold that the "effects" of a subsidy do not have to be proven in order to determine that a subsidy is countervailable.

A subsidy, no matter whether the recipient is located in a market economy country or a non-market economy country, may be used for any purpose, ranging from new production facilities, reducing debt, and helping charities. Or, it may simply be wasted. Yet, neither the SCM Agreement nor U.S. law requires that a subsidy recipient must act differently after receiving a subsidy in order to make that subsidy actionable. Indeed, U.S. law explicitly rules

out an "effects" test,³³ and Commerce has consistently refused to consider the "effects" of a subsidy in determining whether a subsidy exists and how to quantify it. In promulgating revised countervailing duty regulations following the Uruguay Round, Commerce stated:

... Our refusal to read a continuing competitive benefit test (sometimes called an "effects test") into the CVD law was upheld by the Federal Circuit As the CIT explained in *British Steel plc v. United States*, "Commerce has consistently maintained that it does not measure the effects of subsidies once they have been determined by Commerce. In other words, whether subsequent events mitigate these effects is irrelevant." Further, section 771(5)(C) of the Act specifically states that the Department "* * * is not required to consider the effect of the subsidy in determining whether a subsidy exists * * *"

In this regard, it is useful to clarify what we mean in saying that we would not attempt to determine whether a subsidy had any "effect" on the recipient, or whether "subsequent events" might have mitigated or eliminated any potential effects from the subsidy. The term "effect," as used in the statute and SAA, and the term "subsequent events," as used by the Courts, refer to the question of whether a subsidy confers a competitive benefit upon the subsidy recipient or its successor. There is no requirement that the Department determine whether there is a competitive benefit, as is made clear in the SAA (at 926):

* * * the new definition of subsidy does not require that Commerce consider or analyze the effect (including whether there is any effect at all) of a government action on the price or output of the class or kind of merchandise under investigation or review.

In the course of the 1993 steel investigations, certain respondents argued that: (1) A subsidy cannot be countervailed unless it bestows a "competitive benefit" on merchandise exported to the United States; We rejected this argument ... explaining that the statute did not require that a subsidy bestow a competitive benefit on imports to the United States as a condition of liability for countervailing duties. Just as we would not attempt to determine whether a subsidy conferred a competitive benefit on the original recipient in the first place (that is, whether the subsidy had any effect on the original recipient's subsequent performance (usually an effect upon its output or prices)), we would not attempt to determine whether any potential competitive benefit continued with respect to the new owner

³³ Section 771(5)(C) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677(5)(C). This provision states: "The administering authority is not required to consider the effect of the subsidy in determining whether a subsidy exists under this paragraph."

in light of a subsequent event such as a change in ownership. The Federal Circuit upheld this position in *Saarstahl* and *British Steel*. As one commenter noted, the law is concerned with the benefit originally received, not with what the recipient does with it.

In domestic CVD investigations, although the International Trade Commission considers the effect of subsidized imports in its injury determinations, it does not consider the effect of a subsidy on the recipient.³⁴ Stated plainly, the effects of a subsidy, as opposed to the effects of subsidized imports, are irrelevant to the CVD analysis. In any event, money being fungible, how a subsidy is used is not a factor in determining whether to countervail it under domestic law or whether to challenge it under WTO rules.³⁵

Thus, the "effect" of a subsidy has no place in identifying or countervailing a subsidy under U.S. law and Commerce practice. It would be an exceptional departure from established principles for Commerce to decide it must conduct an "effects" test for subsidies in NMEs, but not for subsidies in market-economy countries.

Moreover, as a practical matter, an "effects" test would be expensive, difficult to conduct and ultimately inconclusive. Commerce's past experience in applying an "effects" test, although

³⁴ In cases where the ITC considers whether subsidized imports are a "threat of material injury," the ITC is also directed to consider information from Commerce as to the nature of the subsidy and whether imports of the subject merchandise are likely to increase. See 19 U.S.C. § 1677(7)(F)(i)(1).

³⁵ Even in the case of CVD analyses of privatized entities, the focus is on whether the benefit of the financial contribution (and thus the subsidy itself) continues to exist, not on the effect the subsidy may have on prices or production. The Federal Circuit has distinguished the "effects" of a subsidy (which Commerce is not required to consider under 19 U.S.C. § 1677(5)(C)) from the continued existence of a subsidy after a change in ownership (which Commerce is required to examine). See *Delverde, SRL v. United States*, 202 F.3d 1360, 1367 – 1368 (Fed. Cir. 2000), *reh'g granted in part* (June 20, 2000). Similarly, in reviewing U.S. practice in CVD cases involving privatization, the WTO has directed the U.S. to adequately determine whether a benefit continues to exist after the change in ownership, not to institute an effects test. See, e.g., *United States – Countervailing Measures Concerning Certain Products from the European Communities*, Report of the Appellate Body, WT/DS212/AB/R, adopted January 8, 2003 ("US – CVD Measures"). As a result, the U.S. has been able to successfully comply with its WTO obligations by creating a series of rebuttable presumptions that determine whether the privatization transaction extinguishes the benefit of the subsidy based upon the nature of the privatization transaction itself; the effects of the subsidy on prices or production are not a relevant factor.

not under CVD law, was unproductive.³⁶ It is unlikely that Commerce would want to return to that type of exercise in order to make an unnecessary analysis of changes in behavior by NME firms after receiving subsidies.

B. Applying CVD Law to NMEs Would Not Conflict With or Affect Commerce's Application of Antidumping Law to NMEs.

The application of CVD law to NMEs such as China would not result in any conflict with or affect Commerce's current application of antidumping law to NMEs.

1. China's WTO Accession Protocol directly addresses both antidumping and countervailing duty law.

The most cogent demonstration that AD and CVD law do not conflict in an NME context is the text and structure of China's WTO Accession Protocol. Indeed, China's Protocol of Accession directly addresses the application of special rules by WTO Members in determining both dumping and the level of subsidies where imports from China are concerned and, significantly, deals with them in the same section of the Protocol. Item 15 of the Protocol, titled "Price Comparability in Determining Subsidies and Dumping," explicitly states that, consistent

See Notice of Final Modification of Agency Practice Under Section 123 of the Uruguay Round Agreements Act, 68 FR 37125 (Dep't Comm., June 23, 2003).

³⁶ Before the antidumping law was changed after the Uruguay Round, the Court of International Trade directed Commerce to add foreign indirect taxes in calculating U.S. Price (now Export Price) to the extent they were reflected in home market prices. This led Commerce to apply a "pass through" analysis to determine the amount of the indirect tax that was passed to the purchaser or absorbed by the seller in domestic sales.

Initially, Commerce had simply assumed that the entire amount of such tax was passed through in the price to the customer. However, as a result of an appeal of Commerce's determination in *Television Receiving Sets, Monochrome and Color, from Japan*, 50 FR 24278, 24279 (Dep't Comm. 1985) (final admin. review), the CIT ordered Commerce to calculate the actual amount of the pass-through. *See Zenith Electronics Corp. v. United States*, 633 F. Supp. 1382, 1402 (CIT 1986); *see also Zenith Electronics Corp. v. United States*, 875 F.2d 291, 293 (Fed. Cir. 1989).

On remand, Commerce attempted to calculate the actual pass-through by means of econometric models prepared by interested parties. The models required huge numbers of data points, including price and cost data, over a period of years. The models cost hundreds of thousands of dollars and, not surprisingly, yielded conflicting results depending on assumptions made by the modelers. In addition, the arguments presented were often so arcane that even Commerce staff had difficulty understanding them.

with certain enumerated conditions, "Article VI of the GATT 1994, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Anti-Dumping Agreement") and the SCM Agreement shall apply in proceedings involving imports of Chinese origin into a WTO Member."³⁷ Subsection 15(a) addresses the ability of WTO Members to use special rules for determining normal value in antidumping investigations involving China while subsection 15(b) addresses the ability of WTO members to use alternative valuation approaches for Chinese subsidies. Subsection 15(d) of the Protocol limits the special rules for antidumping to 15 years after accession, but there are no limitations on the use of alternative valuation in subsidy matters involving China. Certainly, China's Protocol would not have addressed both special dumping and subsidy rules in the same section if it was not expected or accepted that both remedies could and would be applied to China. The Protocol does not, in any manner, condition or constrain the application of CVD remedies on Members not invoking NME methodology for AD purposes under subsection 15(a).

2. SCM Agreement and U.S. law definitions do not affect the application of antidumping law.

The SCM Agreement and U.S. law definitions of "financial contribution," "specificity," and "benefit,"³⁸ the three elements that together define an actionable subsidy, do not contain negative implications for U.S. antidumping practices regarding NMEs. Indeed, neither the SCM Agreement nor U.S. law precludes application of CVD law to NME enterprises. The only explicit relationship between AD and CVD remedies is found in GATT Article VI (paragraph 5),

³⁷ Protocol of Accession of the Peoples Republic of China, WT/L/432 (23 November 2001) at Item 15. The text of Item 15 of China's WTO Accession Protocol is attached hereto as an Annex.

³⁸ See *ASCM*, art. 1 (financial contribution), art. 2 (specificity), art. 14 (benefit). See also Section 771 of the Tariff Act of 1930, as amended, at subsections (5)(D) (financial contribution), (5A) (specificity), and (5)(E) (benefit); 19 U.S.C. § 1677(5)(D), (5A), and (5)(E)..

which prohibits the application of antidumping and countervailing duties to compensate for the same situation of dumping or export subsidization. In U.S. law, this prohibition is implemented by adding a countervailing duty for export subsidies to the calculation of U.S. price.³⁹

IV. THE COURTS WOULD LIKELY DEFER TO A REASONED CHANGE IN POLICY BY COMMERCE.

Commerce has applied the current policy of non-application of U.S. CVD law to NMEs continuously since 1984. Commerce's policy, however, is neither based on nor required by statute, regulations or legislative history. As reviewed above, there is good reason for Commerce to change its policy of non-application of U.S. CVD law to NMEs such as China. Even if legally challenged, a change in policy by Commerce that is supported by a reasoned basis would likely be upheld by Commerce's reviewing courts.

Commerce is not legally bound by its 1984 determination and subsequent practice not to apply U.S. countervailing duty law to non-market economy countries in the same sense that Commerce is bound to follow its own regulations. Indeed, Commerce's regulations nowhere state that countervailing duty law only applies to market economy countries. Commerce's practice of non-application of CVD law to NMEs is an exercise of agency discretion and, as such, is subject to reasonable change through the exercise of agency discretion. That Commerce's initial non-application policy decision was a discretionary determination is evident from the 1984 determinations themselves.

It has been recognized that the administering agency has broad discretion in determining the existence or non-existence of the term "bounty or grant." . . . {W}e have exercised this discretion by concluding that a

³⁹ Section 772(c)(1)(C) of the Tariff Act of 1930, as amended; 19 U.S.C. § 1677a(c)(1)(C).

“bounty or grant,” within the meaning of the countervailing duty law, cannot be found in an NME.⁴⁰

That Commerce noted its NME non-application practice in the preamble to its 1998 countervailing duty regulations⁴¹ does not make its practice into a binding rule. In the preamble to the CVD regulations, Commerce merely noted its “practice of not applying the CVD law to non-market economies” and stated that “[w]e intend to continue to follow this practice.”⁴² As the U.S. Government argued before the WTO, under U.S. law, preambles to agency rulemaking notices are treated as “evidence of an agency’s contemporaneous understanding of its proposed rules which may be consulted to determine the proper interpretation of an agency’s regulation” but that “language in the preamble of a regulation is not controlling over the language of a regulation itself.”⁴³ Thus, a statement in the preamble to the CVD regulations noting Commerce’s intention to continue its existing practice of not applying CVD law to NMEs does not bind Commerce to that practice.

More to the point, under U.S. law, an agency is free to change a discretionary practice at any time provided that it provides a reasonable explanation for the change.⁴⁴ Thus, as to its practice of not applying CVD law to NMEs, Commerce “has the flexibility to change its position providing that it explains the basis for its change.”⁴⁵

⁴⁰ *Carbon Steel Wire Rod from Czechoslovakia*, 49 FR at 19374 (emphasis added); *Carbon Steel Wire Rod from Poland*, 49 FR at 19378 (emphasis added).

⁴¹ *Countervailing Duties; Final Rule*, 63 FR 65348, 65360 (November 25, 1998).

⁴² *Id.* at 65360.

⁴³ See *United States - Measures Treating Exports Restraints As Subsidies*, Report of the Panel, WT/DS194/R (29 June 2001) at para. 8.117. See also *Wyoming Outdoor Council v. U.S. Forest Service*, 165 F.3d 43, 53 (D.C. Cir. 1999); *Martin v. OSHRC*, 941 F.2d 1051, 1056 (10th Cir. 1991).

⁴⁴ See, e.g., *Exxon Corp. v. Lujan*, 970 F.2d 757, 762 n.4 (10th Cir. 1992) (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 42 (1983)).

⁴⁵ See *Koenig & Bauer-Abert AG v. United States*, 24 CIT 157, 165, 90 F.Supp.2d 1284, 1292 (2000) (quoting *Cultivos Miramonte S.A. v. United States*, 21 CIT 1059, 1064, 980 F.Supp. 1268, 1274 (1997)).

In reviewing agency interpretations of law where the statute and legislative history are not clear and conclusive, courts normally accord deference to the agency. For example, in *Rust v. Sullivan*, the U.S. Supreme Court said:

When we find, as we do here, that the legislative history is ambiguous and unenlightening on the matters with respect to which the regulations deal, we customarily defer to the expertise of the agency.⁴⁶

Significantly, the Supreme Court said that this deference also extends to an agency's departure from a prior policy when the change is accompanied by a reasoned analysis. The Court stated:

This Court has rejected the argument that an agency's interpretation "is not entitled to deference because it represents a sharp break with prior interpretations" of the statute in question. * * * In *Chevron*,⁴⁷ we held that a revised interpretation deserves deference because "[a]n initial agency interpretation is not instantly carved in stone" and "the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis." * * * An agency is not required to "establish rules of conduct to last forever," * * * but rather "must be given ample latitude to 'adapt [its] rules and policies to the demands of changing circumstances.'"⁴⁸

The principles enunciated in *Rust v. Sullivan* actually support a change in agency interpretations when such interpretations no longer represent the path of wisdom and changing circumstances demand adaptation. Thus, applying *Rust v. Sullivan* here, the following points are most apposite as to why a prudential change in policy would be upheld.

- Commerce's initial policy interpretation was "not instantly carved in stone."
- It is incumbent on Commerce to "consider varying interpretations and the wisdom of its policy on a continuing basis."
- Commerce must be afforded "ample latitude to adapt its rules and policies to the demands of changing circumstances."

⁴⁶ *Rust v. Sullivan*, 500 U.S. 173, 186 (1991).

⁴⁷ *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

⁴⁸ *Rust v. Sullivan*, 500 U.S. at 186-87 (citations omitted).

- Courts will accord deference to a change in policy by Commerce even if it represents a sharp break from prior long-standing policy, as long as Commerce provides a reasoned analysis for its change in policy.

CONCLUSION

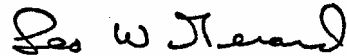
In reviewing the history underlying Commerce's policy decision not to apply U.S. countervailing duty law to NMEs, together with subsequent developments in international rules and changes in the structure of the Chinese economy, what may have been an appropriate approach in the early 1980s is no longer so in 2007.

While China properly remains an NME under U.S. antidumping law, the U.S. has every right to countervail government subsidies to Chinese (and other NME) producers where subsidies are provided and imports are causing or threatening material injury to a domestic industry. Indeed, the U.S. negotiated hard with China during its WTO accession process to address subsidies, to maintain the right for 15 years to use NME methodology in the antidumping context, and to be able, without time limitation, to value subsidies in China under special rules where appropriate. Failure to modify historical practice would result in the U.S. choosing not to avail itself of the full panoply of rights to protect its companies, workers and communities from unfair trade practices at a time when the bilateral trade imbalance with China has dwarfed any bilateral trade imbalance in the history of the world.

Commerce has the authority, without statutory change, to reconsider its current policy of not applying U.S. CVD law to NMEs such as China. Commerce can and should amend this policy without delay in the context of the countervailing duty investigation of coated free sheet paper from China so American companies, workers and communities have confidence that U.S. trade laws are being effectively enforced to see that companies are not harmed, jobs are not lost

and communities are not devastated by the deep pockets of foreign governments. The time for change is now.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Leo W. Gerard". The signature is fluid and cursive, with the first name "Leo" being the most prominent.

Leo W. Gerard
International President
United Steelworkers

ANNEX

PROTOCOL ON THE ACCESSION OF THE PEOPLE'S REPUBLIC OF CHINA WT/L/432 (23 NOVEMBER 2001)

15. Price Comparability in Determining Subsidies and Dumping

Article VI of the GATT 1994, the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 ("Anti-Dumping Agreement") and the SCM Agreement shall apply in proceedings involving imports of Chinese origin into a WTO Member consistent with the following:

- (a) In determining price comparability under Article VI of the GATT 1994 and the Anti-Dumping Agreement, the importing WTO Member shall use either Chinese prices or costs for the industry under investigation or a methodology that is not based on a strict comparison with domestic prices or costs in China based on the following rules:
 - (i) If the producers under investigation can clearly show that market economy conditions prevail in the industry producing the like product with regard to the manufacture, production and sale of that product, the importing WTO Member shall use Chinese prices or costs for the industry under investigation in determining price comparability;
 - (ii) The importing WTO Member may use a methodology that is not based on a strict comparison with domestic prices or costs in China if the producers under investigation cannot clearly show that market economy conditions prevail in the industry producing the like product with regard to manufacture, production and sale of that product.
- (b) In proceedings under Parts II, III and V of the SCM Agreement, when addressing subsidies described in Articles 14(a), 14(b), 14(c) and 14(d), relevant provisions of the SCM Agreement shall apply; however, if there are special difficulties in that application, the importing WTO Member may then use methodologies for identifying and measuring the subsidy benefit which take into account the possibility that prevailing terms and conditions in China may not always be available as appropriate benchmarks. In applying such methodologies, where practicable, the importing WTO Member should adjust such prevailing terms and conditions before considering the use of terms and conditions prevailing outside China.
- (c) The importing WTO Member shall notify methodologies used in accordance with subparagraph (a) to the Committee on Anti-Dumping Practices and shall notify methodologies used in accordance with subparagraph (b) to the Committee on Subsidies and Countervailing Measures.
- (d) Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession. In addition, should China establish, pursuant to the national law of the importing WTO Member, that market economy conditions prevail in a particular industry or sector, the non-market economy provisions of subparagraph (a) shall no longer apply to that industry or sector.